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SPECIAL AD HOC COMMITTEE

COUNTRY REPORT ON THE PHILIPPINES

June 23, 1947

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Reference: SWN-5275

I. ANALYSIS OF THE CURRENT SITUATION IN THE PHILIPPINESA. Basic Forces

1. Economic Forces. Repair of the extensive war damage is the major economic problem of the Philippine Islands. To date relatively little progress has been made in this direction. Work on the various public projects authorized under the Philippine Rehabilitation Act has just been started and private reconstruction activity has been limited in scope. Aside from administrative delays in the case of public projects, physical rehabilitation of the economy has been impeded by the difficulties of procuring essential industrial equipment and supplies, by inadequate local financing facilities, and by inflated domestic prices. However, these unfavorable conditions are gradually being improved. The tight equipment situation in the US is easing, and export controls are being relaxed. War damage payments under the Rehabilitation Act and the establishment of a Philippine Reconstruction Finance Corporation will ameliorate the problem of local financing. Prices have fallen steadily; the cost of living is 50 percent below its postwar peak, although still three times above prewar.

A second major problem of the Philippine Republic is the financing of the government's cost of operation. Despite the fact that the national income is estimated at approximately three times the prewar level, government revenues for fiscal 1947, reflecting in large part a lax and often corrupt tax system, will meet only about 40 percent of expenditures. The problem of financing this deficit is complicated by the fact that internal borrowing for the purpose has not been practical. Accordingly, an external budgetary loan from the United States has had to be arranged. The prospects are that similar assistance will be requested for the next few years.

Despite limited physical rehabilitation and government fiscal problems, general economic conditions in the Philippines are better than in other areas that were occupied by the Japanese. The threat of a food crisis has passed. Domestic production of foodstuffs, the main economic activity of the Islands, with the addition of International Emergency Food Council (IEFC) allocations, should permit a per capita diet in 1947 close to prewar

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consumption. The local textile market is well supplied. Only in the case of housing is the situation still serious. The most favorable factor in the Philippine economic situation is the country's strong foreign exchange position. During 1947, dollar receipts, largely in the form of US Government outlays, will exceed US \$700 million, or more than three and a half times the 1938-40 annual average. They will finance almost three times the average prewar physical volume of imports at current prices. These receipts will continue at a high, although declining, level through 1951, aggregating about \$2.4 billion for the five-year period. If imports for the period are limited in the main to goods required to maintain adequate living standards and finance reconstruction, Philippine dollar receipts should be more than adequate.

2. Political and Social Forces. At the end of the first year of Philippine independence, political and social conditions in the Republic are generally stable. The pro-American administration of President Roxas firmly controls both Houses of Congress and the local governments by the machinery of the Liberal Party, and commands the loyalty of the armed forces. The Congress has ratified without exception all administration-sponsored treaties with the United States. The vote in the recent "parity" plebiscite (as to whether to grant to US citizens equal rights in exploiting Philippine natural resources) testified to a great increase in popular support for the Liberals since the April 1946 election. The underlying political stability of the Republic is provided by a written constitution patterned after the US Constitution, while the presence of US troops and the retention of US military and naval bases in the Philippines are indirect stabilizing factors. The potential threat to government authority presented by the Hukbalahap, a leftist organization of armed peasants on Luzon, has been reduced to infrequent skirmishes with the Military Police Command. However, continuing social unrest is to be expected until there is stricter enforcement and further expansion of the government's program of agrarian reform. The Republic has no dissident minority problems comparable to those of other countries of Southeast Asia. Although the Moros still represent a problem of cultural assimilation, their warlike activities have greatly diminished in recent years. The largest alien minority, the Chinese,

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numbers less than one percent of the population. Some instances of social and political instability, notably the widespread petty banditry and a few cases of corruption in government, have apparently been caused by a continuation of wartime standards of public morality under the Japanese occupation.

The Liberals, who now occupy approximately two-thirds of the congressional seats, are supported by the large Philippine business interests and by some liberal elements, mostly guerrilla veterans, and a few former collaborators. Nominally committed to bringing about a liberal democracy in the Philippines, they have espoused policies slightly more progressive than those of previous administrations. Their main legislative activities so far have concentrated on rehabilitation of the economy and cooperation with the US. The other major party, the Nacionalista -- affiliated with the left-of-center Democratic Alliance -- affords a rallying point for the more nationalistic forces of the Republic. (However, the two major parties' political philosophies do not differ materially otherwise.) The influence of minor parties in Philippine politics is negligible. The Communist Party numbers less than a thousand members in a predominantly Catholic population. Labor unions play an insignificant but growing political role.

Anti-American sentiment in the Philippines has declined recently, partly as a result of the successful negotiation of outstanding American-Philippine treaties such as the Military Bases Agreement and the reductions in American forces in the Philippines. However, popular resentment is directed against US treatment of Philippine war veterans. The free press is generally impartial but readily expresses opposition to any apparent violation of the new Philippine sovereignty.

B. Objectives and Methods of Other Nations

The aims and activities of other nations in the Philippines are of minor importance relative to those of the United States. China apparently is interested mainly in procuring freedom from economic discrimination for the Chinese minority in the Philippines. British policy toward the Philippines is directed primarily at using the preferential nature of American-Philippine trade relations as a bargaining point to justify preferential agreements for Great Britain with other countries. The USSR, which has not accorded diplomatic recognition to the Philippine Republic, utilizes these preferential

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American-Philippine relations in its foreign broadcasts as an example of "imperialistic" US foreign policy. Spain recently has showed renewed interest in strengthening its existing political, social, and cultural ties with the Philippines.

II. ANALYSIS OF ASSISTANCE ALREADY RENDERED

A. Analysis of Political and Economic Premises on Which Aid Was Based

The assistance tendered by the US to the Philippines was based primarily on respect for American prewar and wartime promises "to assist in making the Philippines, as an independent nation, economically secure." This aid also was based on US recognition of its liability for legal obligations continuing from the period of American sovereignty over the Philippines and on a sense of gratitude for the Philippine war effort. It was further appreciated that assistance legislation would help maintain a democratic government in the Philippines, increase US prestige in the Far East, and bring about "closer cooperation and greater understanding" between the US and the Philippine Republic.

It was believed that Philippine political independence could not be maintained without measures insuring economic security both in short-run aspects of rehabilitation of the war-devastated economy to its prewar status and establishment of budgetary solvency and in the long-run aspects of technological development toward a greater degree of economic self-sufficiency. Military assistance was provided to help establish and maintain Philippine national security.

B. Summary of Assistance Given

Principal categories of US Government aid given to the Philippines since independence or available during fiscal year 1947 or until spent are summarized below:

1. Direct Aid

a. War damage claims under Philippine Rehabilitation Act of

1946, Public Law 370, 79th Congress* \$10,000,000

b. Transfer of surplus property under the Philippine

Rehabilitation Act, property valued at 100,000,000

* The Philippine Rehabilitation Act authorizes (1) the appropriation of \$400 million as compensation for war damage to individuals and private organizations and \$120 million plus such additional sums as may be necessary to restore and improve public property and essential services and (2) the transfer without compensation of US surplus property not to exceed a value of \$100 million.

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- c. Funds for restoration of public roads, port facilities, public property, and health services under the Philippine Rehabilitation Act \$33,000,000
- d. Funds for the rehabilitation of inter-island commerce, inter-island air navigation, weather information, fisheries, and coast and geodetic surveys, and for the training of Filipinos in the US under the Philippine Rehabilitation Act 10,910,000
- e. Payment to the Philippine Government in return for its assumption of responsibility for redemption of guerrilla currency issued by authority of US during war, by transfer of surplus property valued at \$37 million and cash payment of \$25 million less \$5 million for cultural exchange program and for purchase of real estate in the Philippines for use of the US 57,000,000
- f. Advance under terms of Public Law 656 of 79th Congress, which authorized the Reconstruction Finance Corporation to lend or extend credit to the Philippine Government for fiscal year 1947 in an amount not exceeding \$75 million 70,000,000
- g. Pursuant to Public Law No. 454 of the 79th Congress an agreement was concluded between the US and the Philippine Republic whereby the US would provide military assistance to the Philippines for 5 years commencing July 4, 1946. Under the terms of the agreement the US transferred to the Philippine Government army and air force equipment with a procurement cost of \$35,957,812 and for fiscal year 1947 furnished the Philippine Army with food, fuel, and clothing valued at \$6,487,000 42,444,812
TOTAL \$323,354,812
- h. Pursuant to the military assistance agreement referred to above, a US military group of 49 army officers and men, and 39 naval officers and men are advising and assisting the Philippine Republic in military and naval matters.

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1. The War Shipping Administration and subsequently the Maritime Commission provided most of the inter-island shipping services in the Philippines after the war. These services, which were operated at a loss, afforded a fairly adequate substitute for the Philippine inter-island fleet, which was almost wholly destroyed during the war. The vessels used were recently transferred to Philippine ownership.

2. Indirect Aid

- a. The Philippine Trade Act of 1946 (Public Law 371, 79th Congress) provides for eight years of free trade between the United States and the Philippines and for a subsequent twenty-year period of declining customs preferences during which the rates of United States and Philippine duties will be gradually increased, until, by 1973, preferences will be eliminated.
- b. A number of special missions of technical experts -- including housing, agricultural, financial missions -- have been sent to the Philippines to advise the government on economic problems of reconstruction.
- c. Army and navy expenditures and veterans' benefits will aggregate approximately \$300 million in 1947 and \$700 million over the next 5 years. These payments are thus greater than those provided under the Philippine Rehabilitation Act.

C. Assistance Pending or Contemplated

1. Under the terms of the Philippine Rehabilitation Act, the following additional amounts may be expected to be made available from time to time until June 30, 1950:

| | |
|--|---------------|
| a. War Damage claims | \$390,000,000 |
| b. Funds for the restoration of public roads, port facilities, public property, and health services | 87,000,000 |
| c. Funds for the rehabilitation of inter-island commerce, inter-island air navigation, weather information, fisheries, coast and geodetic surveys, and for training of Filipinos in the US, estimated at | 10,000,000 |
| TOTAL | \$532,000,000 |

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2. Pursuant to the military assistance agreement army and air force equipment worth \$19,302,880 and ships and naval equipment with a procurement cost of \$47,500,000 will be turned over to the Philippines in the near future. The Philippine Government has requested food, fuel, and clothing aid for its army during fiscal 1948 valued at 9.4 million. This request is now under consideration.

D. Contribution of Aid to Philippine Recovery

US aid has materially furthered Philippine economic recovery. Budgetary assistance has enabled the Philippine Republic to provide services essential to the maintenance of organized government during the postwar transitional period of serious fiscal disorganization. Coastal shipping furnished by the Maritime Commission and motor vehicles and rolling stock from surplus property transfers have provided the basis for reestablishing vital water and land transportation facilities. Surplus property has also included some essential equipment and supplies needed for the rehabilitation of industry and agriculture. Indirectly, United States financial aid has provided an offset against the current large Philippine trade deficit. The value of Philippine imports is now more than twice the value of exports. United States aid payments more than cover the discrepancy.

However, the effects of US aid have not been entirely beneficial. A significant result of this assistance has been a substantial currency inflation in the Philippines despite the fact that the peso has 100 percent dollar backing. US expenditures, principally military outlays, have outstripped the availability of goods, thus raising prices substantially above prewar levels. Although the cost of living is still three times higher than it was in 1940, the price trend is now downward. This downward trend will continue as the flow of goods from the US increases until the price levels in the Philippines and the US approach equilibrium.

E. Political Effects of This Aid

It is probable that this aid has contributed to the increased popular support and legislative strength of the pro-American Liberal administration. It has helped to alleviate economic causes of social unrest and thus provided a framework of law and order for the functioning of legitimate government.

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US military equipment transferred to the Philippine Government has been instrumental in suppressing the threat of the Hukbalahap to the government. Furthermore, the aid has made public opinion more favorable to US policy, although there is probably still a slight residue of fear of American "imperialistic" motives in the Philippines.

III. US OBJECTIVES IN THE PHILIPPINE REPUBLIC

In general, US policy is directed toward encouraging the creation and maintenance of a strong, independent, democratic, and friendly Philippine Republic. While recognizing its liability for certain obligations continuing from the period of American sovereignty over the Philippines, the US nevertheless attempts to place all its relations with the Philippines on the basis of dealings between sovereign nations.

Specifically, US policy is concerned with the success of democratic elements and a truly representative form of government in the Philippines. It is believed that achievement of these aims, together with attainment of economic objectives, will not only demonstrate to the other peoples of the Far East the compatibility of political democracy and economic welfare but also strengthen ties of ideological sympathy between the two countries. The US is also interested in alleviation by the Philippine Government of the underlying social and economic causes of the present agrarian unrest. Economic objectives of the US in the Philippines include the rehabilitation of the war devastated Philippine economy, the establishment of mutually beneficial trade relations, the diversification and gradual development of the Philippine economy toward a state of less dependence on US Preferential tariffs, the protection of present US investments and the enlargement of opportunities for US capital investments there. US policy further aims at contributing to the mutual protection of the two countries through US military and naval bases in the Islands and bilateral military agreements. The US desires to encourage active Philippine participation in the United Nations and all its specialized agencies and has respected its independent action therein. Finally, US policy seeks to keep open the channels for the exchange of information and cultural values in order to avoid misunderstandings and misrepresentations between the two countries and to stimulate the cultural evolution of the Philippines.

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Available evidence does not demonstrate a Philippine need for external financial assistance for budgetary or reconstruction purposes in addition to that already given, authorized, or anticipated in order to insure the accomplishment of US objectives. Balance of payments estimates for the five-year period 1947-51 indicate that dollar receipts will yield a surplus of more than \$1 billion after financing annual imports at the 1938-40 average rate (allowing a 50 percent increase for higher prices). This surplus, if effectively employed should be adequate for reconstruction and development purposes, and probably will fully tax the absorptive capacity of the Philippine economy. Dollar receipts will be even greater if any of the various proposals before the US Congress to increase benefits to Philippine veterans are approved. Additional dollars also are available from the accumulated cash holdings of the Philippine public. Peso circulation, which is backed by 100 percent dollar reserves, is at three times the prewar level and is being gradually reduced without harmful economic effects. The fact that the Philippines enjoys a very favorable foreign exchange position does not of itself guarantee, however, that sufficient funds will be available to finance rehabilitation needs. The Philippine public may not show sufficient disposition to provide needed investment capital and may dissipate substantial amounts of foreign exchange on non-essential imports. Under these circumstances, the Philippine Government might consider it desirable to impose some controls on imports and capital transfers in order to facilitate financing of reconstruction and development projects either directly or through investment in Philippine Government bond issues. The establishment of a central bank and the introduction of a fractional reserve currency system would facilitate the mobilization of private capital by the Philippine Government.

Although the Philippine Government desires additional budgetary loans from the United States to cover anticipated deficits through 1950, it is the opinion of the American members of the Joint US-Philippine Financial Commission that such assistance will be unnecessary for fiscal year 1948 or in the foreseeable future. In their view a program of vigorous tax administration, increased rates of taxation and new taxes would provide the

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Philippine Government with sufficient revenues to finance its operating costs. Should such a program fail to yield sufficient revenue, budgetary retrenchment and a small uncovered note issue guaranteed by the US stabilization fund are recommended rather than a US loan. According to the American members, further budgetary loans would merely result in postponing necessary action to clean up the present lax and corrupt Philippine tax administration. In addition, repayment of such loans at a time when the balance of payments is less favorable could prove extremely burdensome.

B. Political Means

Most objectives of US policy in the Philippines are being achieved by existing US aid legislation. Political action should be directed primarily toward the maintenance of present amicable relations between the two countries. To this end, the plan currently being considered by the US Government to sponsor legislation granting additional benefits to Philippine army veterans for wartime services in the US armed forces is important. Granting to these veterans benefits more comparable to those received by American veterans would serve to eliminate an outstanding cause of anti-American public sentiment in the Philippines. It would also help offset any friction that may result from American refusal to extend additional financial aid. In addition, it is desirable that future US policy actions in support of democratic forces in the Philippines and a truly representative Philippine Government stress the respect of the US for Philippine independence and sovereignty. With diplomatic discretion, one policy move would be to express encouragement for the implementation and enlargement of the Philippine Government's program of agrarian reform, which would tend to broaden the basis of land tenure and alleviate the most important source of social unrest in the Philippines. It is further suggested that, in the event of the continuance of the present trend toward a one-party political system in the Philippines, the US Government should bring indirect pressure through its representatives in the Philippines for the retention of a two-party system.

C. United Nations Assistance

The United Nations provides a useful vehicle for furthering United States policy objectives in the Philippines. Independent, active participation by the Philippines in the United Nations and its specialized agencies contributes to the international prestige and strength of the Republic. Friendly relations between the two governments can be furthered by United

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States support of Philippine membership in the Councils, Commissions, etc., of these bodies and by United States support of proposals designed to extend the services of these organizations to the Philippines. Some of these services can, as the organizations enter into full operation, contribute to the improvement of economic and social conditions in the Philippines, and thus contribute to its political stability. Such international assistance would, without impairing in any way the friendly relations between the two countries, lessen the degree of dependency of the Philippines on the United States and thereby strengthen its independent status.

V. MAGNITUDE, NATURE, AND TIMING OF THE MEASURES REQUIRED WITHIN THE NEXT THREE TO FIVE YEARS TO REACH THESE OBJECTIVES

A. Economic Measures

As indicated in Section IV-A above, the Philippine Republic should be able to finance government operating costs and reconstruction and development needs without recourse to additional external aid. The problem is essentially one of utilizing available financial resources effectively.

B. Political Measures

In regard to the magnitude, nature, and timing of measures granting additional benefits to the Philippine Army veterans, it seems most feasible to adopt the recommendations of the interdepartmental committee that is at present deliberating on the issue. It is apparent, moreover, that the nature and timing of the measure will be affected by the legislative action of the US Congress. However, it would be desirable that such a measure grant, as a minimum, the following benefits: to recognized guerrillas, pensions for service-connected disability or death and National Service Life Insurance policies; to USAFFE (United States Army Forces in the Far East) veterans, some assistance in medical care and hospitalization and educational benefits. It would be desirable that actual disbursement of the benefits coincide as closely as possible with the expected announcement of the US decision not to grant additional budgetary loans to the Philippines and precede the November 1947 elections in the Philippines in order to reduce the number of anti-American campaign speeches.

VI. PROBABLE AVAILABILITY OF AID FROM EXISTING SOURCES UNDER PRESENT POLICIES

A. US Sources

US Government policy with respect to the question of extending additional

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economic aid to the Philippines is likely to be governed primarily, exclusive of domestic political considerations, by the recommendations of the American members of the Joint US-Philippine Financial Commission. The American members, as indicated in Section IV-A, are opposed to budgetary assistance after fiscal 1947. In view of the very strong dollar position of the Philippines, they are not likely to recommend early additional aid for reconstruction and development. It may be surmised that the American members will recommend further aid only if the Philippine Government conscientiously tries and finds inadequate their proposals for financing the country's needs from internal sources.

B. International Sources

Two potential sources of international economic assistance are the International Monetary Fund and the International Bank for Reconstruction and Development. However, in view of its strong balance of payments position and its 100 percent reserve currency system, it is improbable that the Philippines will require or be eligible for aid from the Fund. Whether or not the International Bank for Reconstruction and Development will be prepared to extend financial aid to the Philippines will depend on the criteria the Bank uses in considering loan requests. The indications are that the Bank will give primary consideration to the credit risks involved and secondary consideration to need. On the basis of these criteria, the Philippines probably could obtain fairly substantial assistance. However, if need is given primary stress the Philippines probably will be given low priority.

VII. ADDITIONAL MEASURES REQUIRED FROM THE UNITED STATES

As pointed out in Section IV-A, the Philippine Republic should not require additional external financial assistance, provided that the necessary measures are taken to mobilize effectively the country's available financial resources. The United States Government should be prepared to assist the Philippines in preparing and administering a program to this end by lending required trained personnel. In addition, this country should not allow the provisions of the Philippine Trade Act of 1946 to interfere with the carrying out of required control measures. The US, for example, should not oppose the temporary application by the Philippine Government of exchange and import controls if such action appears to be called for in order to conserve foreign exchange.

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Further, if possible the US should assist the Philippines in procuring urgently needed equipment and supplies from American manufacturers through the use of priorities. Finally, in view of the magnitude of the Philippine reconstruction problem, the US should offer technical and administrative assistance to help effect rehabilitation in an orderly and efficient fashion.

VIII. NATURE OF ARRANGEMENTS WITH PHILIPPINE GOVERNMENT TO ASSURE ACCOMPLISHMENT OF US OBJECTIVES IN TAKING SUCH MEASURES

It is the recommendation of this paper that no further US aid, be given the Philippines until all possible measures to exploit the country's present favorable financial position have been exhausted. Then, if it is decided that additional assistance is necessary, to the extent that it is required for rehabilitation or development purposes it should take the form of US supervised projects for which the necessary equipment and supplies are provided rather than money payments. This will minimize the inflationary affects of the assistance and help insure that the aid is not diverted into uneconomic channels.

IX. EFFECTS UPON THE PHILIPPINES AND UPON US FOREIGN POLICY OF US REFUSAL TO GRANT AID OR OF FAILURE OF PROGRAM UNDERTAKEN

A. Economic Effects

No adverse economic consequences will result from US failure to grant additional aid to the Philippines, provided that the Philippine Government institutes needed financial reforms. However, if the Philippine Government fails to adopt such measures, there is a serious possibility that the US aid now authorized will accomplish little in the way of Philippine economic reconstruction and development.

B. Political Effects

Some criticism of the US undoubtedly will result from the failure to grant additional economic aid to the Philippines, especially in view of the assistance being given other foreign countries. However, this criticism will probably not basically damage Philippine-US relations. The granting of additional veterans' benefits to Philippine Army veterans would probably offset this source of ill will.

X. POSSIBLE EMERGENCY SITUATION WHICH SHOULD BE ANTICIPATED

No emergency situation need be anticipated.

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DECISION ON
COUNTRY REPORT ON THE PHILIPPINES

Note by the Secretary

On 9 July 1947 the Subcommittee informally approved, without change, the Country Report on the Philippines dated 23 June 1947. Subject report was forwarded to the SWNCC Special Ad Hoc Committee on the same date.

J. B. CRESAP,
Comdr. USN,
Secretary

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